

TEACHERS' RETIREMENT BOARD

REGULAR BOARD MEETING

SUBJECT: Permanent Contingency-Alternative Disbursing
Agent (ADA) Services

ITEM NUMBER: 9

ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: October 14, 1999

INFORMATION: _____

PRESENTER(S): Mr. Martin

SUMMARY

The CalSTRS provides monthly allowance roll payments to 160,000 members and beneficiaries through the State Controller's Office (SCO), the State's disbursing agent. At this time, the System has no back-up or comprehensive contingency in place if an event (earthquake, flood, cyber-terrorism, labor action, budget impasse, etc.) prevents the SCO from producing warrants and electronic funds transfer (EFT) payments.

DISCUSSION

The CalSTRS processes payment data within its On-Line Information System and passes detail, in the form of computer files, to the SCO. Depending on the type of data (hard copy warrant or EFT), the SCO performs parameter verification functions, prints and mails warrants, conditions the EFT data and passes it to the EFT agent bank, Bank of America, for further processing. The data is then forwarded to VisaNet and the Federal Wire System (FWS). At VisaNet, member banks download data and funds for posting to customer accounts. The remaining data and funds are transmitted over the FWS for eventual download by non-VisaNet customer banks.

Historically, the SCO has been a very reliable and cost effective business partner. CalSTRS staff cannot recall any failure of the SCO to properly and timely process payment data. Both the SCO and CalSTRS as well as the State Treasurer's Office (STO), the third partner in the CalSTRS benefit payment process, are all under the state government umbrella, providing consistency in processes and structure.

Even with the excellent track record of the SCO, there remains the remote possibility that an event could take place in the future that would hinder or altogether prevent the SCO from processing CalSTRS data and providing monthly allowance roll payments to members and beneficiaries.

CalSTRS has a contract for "hot site" emergency computer services. At this out-of-state location, CalSTRS has the ability to generate the monthly allowance roll in both hard copy warrant and

EFT formats. While the SCO also has similar capability, further improving the chances for recovery, there nevertheless remains the possibility of an occurrence which might preclude the SCO or other segment within the current disbursement conduit to complete the payment function. With an alternative disbursement conduit, CalSTRS increases significantly the chances for regular monthly payment during the time of an extraordinary event.

CalSTRS staff has researched the possibility of securing the services of a contingent disbursing agent in the event the SCO cannot process payments. This research involved meeting with financial institutions and payroll service firms as well as conducting a survey of other state retirement systems and insurance companies (attachment) to gather information as to their contingency plans.

ALTERNATIVES

Alternative 1: Continue with no contingency in place. This alternative assumes that the potential for an event that will prevent the SCO from making payments is so slight that it does not warrant taking any action to ensure the payment of benefits. The only advantage of this alternative is that no CalSTRS staff time will be needed to develop procedures and for computer programming to provide for a contingency action. Although the chance that any contingency measures will be used is very slight, this alternative does not provide the necessary levels of due diligence that staff believes is needed to deliver benefits and services to meet CalSTRS' fiduciary responsibility to provide timely benefit payments.

Alternative 2: CalSTRS produce warrants in-house in the event the SCO is unable to make payment. This alternative relies on CalSTRS to be the contingent back-up and produce warrants in-house in the event the SCO cannot produce payments. CalSTRS would be required to purchase the necessary equipment (laser printers and folding/inserting machines) and supplies (check stock and envelopes). Also, a secured environment to produce the checks would be needed. In addition to providing a back-up in the event the SCO cannot process the CalSTRS payments, it allows CalSTRS more control in the disbursement of benefits. Disadvantages include the cost for purchasing equipment and supplies (\$750,000 in one-time costs and an additional \$70,000 per month when the contingency is in use), the need for a secured area, a contract for consultant services as CalSTRS has no experience in implementing a check processing function, contracting with a commercial bank to perform EFT services and CalSTRS assuming responsibility for producing payments. Also, this alternative would still require a contingency plan in the event both the SCO and CalSTRS are unable to produce payments.

Alternative 3: Contract with outside vendor to provide backup disbursement services. Under this alternative, CalSTRS would contract for disbursement services with a commercial bank. The bank would develop systems to accommodate CalSTRS EFT and check detail. CalSTRS would

generate the EFT and check detail and pass on to the bank who would perform “front end” parameter checks and then transmit the electronic funds payments and either print the checks themselves or pass the detail to a check writing vendor. Once the checks were printed and mailed, the bank would activate their banking system to accommodate the tracking, reconciliation and re-purchase of negotiated checks as well as rejected/returned EFT items and provide CalSTRS both on-line and printed reports to document all payment activity. Advantages in using this alternative are using an vendor experienced in printing and distributing checks and the vendor assuming responsibility for producing the payments and developing a contingency plan. Disadvantages include the cost for set-up, testing and installation by the commercial bank (\$150,000 in one-time costs) plus a monthly contingency stand-by fee of approximately \$12,000.

RECOMMENDATION

Staff recommends that the Board approve funding for alternative #3, a contract with a commercial disbursing agent to provide contingent disbursement services on a continuing basis for CalSTRS in the event the SCO cannot produce payments due to extraordinary circumstances.

Although having the availability of a contingent disbursing agent would not provide a guarantee of payment under all conditions, the chances of successfully responding to such scenarios with another payment option is increased with a commercial bank serving as a back-up.

CONTINGENT DISBURSEMENT SURVEY RESULTS

10/05/99

Entity	Prepares Checks	If no, entity that prepares checks	% Checks vs. EFT	Contingency Plan	Comments
A	No	State Controller	20/80	EFT-No, Checks-No	System is in process of negotiating contract with outside bank to provide contingent disbursement services for both EFT and check printing in the event of failure with State Controller.
B	No	State Department of General Services	20/80	EFT-Yes, Checks-No	Has arrangement with local bank to send EFT payment in the event Dept of General Services EFT banks fails. If back-up EFT bank fails, plan is to print and send checks internally.
C	No	State Controller	Unknown	EFT-No, Checks-No	System has no authority to contract outside for disbursement services. System is more confident with the State Controller than contracting with bank. System has own mainframe and has back-up (hot site) 170 miles away. System is considering closing all processes on December 29, thus freezing their database and not re-opening until new year. In the event the State Controller encounters a problem, System feels necessary resources will be used to correct problem in shortest time possible.
D	Yes	N/A	16/84	EFT-Yes, Checks-Yes	System will print checks if there is an EFT failure. Has arrangement with another state agency to produce checks in the event System is unable to do so. System developed contingency plan five years ago and periodically updates as needed. System has installed generator for back-up, electronic locks and fire retardant system.
E	No	State Controller	16/84	EFT-No, Checks-No	System has no authority to contract outside for disbursement services. State Controller has signed letter certifying they are Y2K compliant. State Controller supposedly has back-up plan in the event of failure.
F	Yes	N/A	20/80	EFT-Yes, Checks-No	System prints checks internally. Has contract with outside vendor for disaster recovery (data). System has arrangement with bank for EFT payments. If EFT fails, System will produce checks in house. System has purchased property out-of-state to build hot site where they will be able to print checks in the event of failure. Facility will be completed in November 2000.
G	Yes	N/A	50/50	EFT-Yes, Checks-No	System prints check internally and has no back-up currently available if unable to produce. System is currently in process of seeking outside entity to print checks, but has had no success. If EFT fails, System will print checks internally.
H	No	State Auditor (Controller)	20/80	EFT-Yes, Checks-No	No back-up plan in place for checks. If EFT fails, State Auditor will produce checks.
I	Yes	N/A	Unknown	EFT-Yes, Checks-Yes	Company has developed and implemented internal contingency plan and continually tests to ensure back-up system will function in the event of disaster. Due to the company's confidential requirements, they were not able to provide any specific details regarding their back-up plan. However, in the event of EFT failure, company would print checks until failure is rectified.
J	Unknown	N/A	Unknown	Unknown	Company did not return phone calls.
K	Unknown	N/A	Unknown	Unknown	Company does have contingency plan in place, but did not disclose.

CalSTRS staff contacted a total of 11 entities (eight state retirement systems and three insurance companies).